



October 3, 2008

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COMMUNICATIONS  
ADMINISTRATION

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
U.S. Department of Labor  
200 Constitution Avenue, N.W.  
Washington, D.C. 20210  
Attn: Investment Advice Regulations, Room N-5655

Re: Eligible Investment Advice Arrangements

To Whom It May Concern:

Hartford Financial Services Group (“Hartford”) is one of the nationally leading providers of retirement plans and of variable annuities owned by plan participants within retirement programs.<sup>1</sup> Accordingly, we share with the Department a vital interest in the development of sound regulations advancing the efficacy of the retirement system for plan participants, beneficiaries and sponsors.

We commend the Department for its recent release of proposed regulations to implement the eligible investment advice arrangement exemption enacted in Section 601 of the Pension Protection Act of 2006 (ERISA Sections 408(b)(14) and 408(g)), and the related proposed class exemption. We believe the Department’s proposals appropriately give effect to the policy decisions reflected in those provisions, in a manner that safeguards the interests of participants and beneficiaries within a regulatory setting that permits the sensible delivery of investment advice services to them.

In the context of the services we provide to the retirement community, we particularly appreciate the utility and value of professional investment advice within the context of annuity contracts, in the belief that the burgeoning use of variable annuities to meet participant needs is, and will continue to be, a significant benefit and economic safety net to retiring Americans for decades to come. The current volatility in the markets is a reminder of the potential value to retirement security of both professional advice while workers are building retirement savings and annuity guarantees that protect retirees from not only longevity but also market risk. In that respect, we offer the following suggestions that we believe would promote the broad purposes of Sections 408(b)(14) and 408(g), while also providing protections to participants and beneficiaries

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<sup>1</sup> For convenience, references in this letter to retirement plan participants are generally intended to also encompass retirement plan beneficiaries and IRA owners and beneficiaries.

consistent with those provisions. First, we request that the Department clarify the circumstances where investment activity is deemed to occur “solely at the direction” of the participant. Specifically, the Department should make it clear that the activities of a fiduciary adviser in an “opt out” dynamic asset allocation structure are within the scope of the relief provided under section 408(b)(14), under either the level fee provision or the computer model provision of section 408(g). Second, at the Department’s request, we provide information about Hartford’s bonus system, which we believe is consistent with the Department’s interpretation of section 408(g)(2)(A)(i) in Field Assistance Bulletin (“FAB”) 2007-01 (Feb. 2, 2007) and proposed Section 2550.408g-1(c)(1)(iii) permitting bonuses for fiduciary advisers based on aggregate business results under the “level fee” exemptions.

#### Scope of Participant Direction.

The objective of Congress in enacting section 408(b)(14) was to provide a conditional but comprehensive solution for the prohibited transaction issues involved in investment advice arrangements for participant directed plans. Under the advisory structures currently in use today, those issues most typically arise where the advice either consists of recommendations on individual securities or takes the form of a dynamic asset allocation model.

#### *Operation of Opt-Out Dynamic Asset Allocation Models*

Asset allocation models are commonly offered with registered variable contracts and in conjunction with retirement plans. For these purposes, models can be categorized in one of two ways: static and dynamic. We believe that static models—where the investment allocations are approved in advance by the participant and do not change thereafter, with the fiduciary adviser at most periodically rebalancing the account to the participant’s original specifications—are unambiguously within the scope of section 408(b)(14) and 408(g), so we focus our comments on dynamic models.

In Hartford’s retirement business, dynamic asset allocation has emerged as a highly attractive service for participants. Among other things, it couples access to model portfolios (i.e., a universe of investment options designed to optimize investment returns matched to predominant risk tolerance profiles or investment strategies) with the convenience and efficiency of a tool that can reallocate holdings (often with no separate charge) to continuously accommodate the participant’s investment goals, time horizons and risk tolerances. Dynamic asset allocation has also been beneficial to avoid excessively aggressive investment behavior in the context of guaranteed benefits tied to peak contract values.<sup>2</sup>

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<sup>2</sup> These investment restrictions may be associated with guaranteed minimum death or withdrawal benefits that are reset from time-to-time based on a “peak” or “maximum” contract value. For instance, a guaranteed minimum death benefit could be periodically reset to be the highest contract value attained. Accordingly, even if the contract value eventually fell below this high point, the insurer would still be obligated to pay a death benefit fixed at the peak contract value. A typical investment restriction used to manage against overly aggressive investment behavior could be to limit the types of permissible model portfolios (e.g., conservative or moderate risk) or limit the percentage of assets that may be invested in predetermined equity funds (e.g., not more than 70%). By making the selection of one or more acceptable asset allocation models a condition to the availability of these guarantees, the insurer can

Recognizing that there may be variation in practice in the industry, the following is our dynamic asset allocation process under a Hartford variable annuity contract. In the context of the eligible investment advice arrangement exemptions, the Hartford contract would make available a significant number of proprietary and nonproprietary investment options ranging across all generally recognized asset classes, and generally with two or more representatives in each asset class. In the IRA setting and under some retirement plans, the full range of options would be available to the IRA owner or plan participant; in some retirement plans, the appropriate plan fiduciary may narrow the options from which the participant may select under the plan. The role of the fiduciary adviser would be to provide ongoing advice to the IRA owner or plan participant, through the use of dynamic asset allocation models, as to the investment of his or her account. This advice arrangement would operate as follows:

- Hartford selects certain of the funds available under its product to be eligible investment options for the asset allocation model portfolios.
- A registered investment adviser affiliated with Hartford and acting as fiduciary adviser develops and maintains several asset allocation models. Various model portfolios are offered, each corresponding to a different hypothetical investment profile based on the participant's timeframe and willingness to accept risk. Each model portfolio developed by the fiduciary adviser specifies the percentage of assets that are allocated to specified investment options. The fiduciary adviser considers generally accepted investment theories that take into account the historic returns of different asset classes (i.e., equities, bonds, or cash) over different time periods when developing the asset class allocations for the models. The fiduciary adviser also evaluates eligible investment options identified by Hartford to determine the specific options to use in the model portfolios.
- The fiduciary adviser and the participant enter into an investment advisory agreement. The fiduciary adviser provides each participant with educational information on the various asset allocation model options but does not advise on which model the participant should choose. Thus, each participant selects an asset allocation model on the basis of his or her independent decision making process, which may include, among other things, a self-assessment of the participant's investment horizon and appetite for risk aided by various educational and self-diagnostic tools. Questionnaires are often used as tools by registered representatives to help clients assess their risk tolerance or can be self-scored by investors. As a result, the participant is educated as to the types of asset allocation models that would appear to be consistent with the goals and sensitivities of a comparable hypothetical investor.

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properly underwrite, internally hedge and charge for the risk it assumes. Otherwise, the insurer would out of prudence have to assume that all participants will elect the most aggressive investment strategy allowable under the plan, resulting in cost inefficiencies for participants who pursue any different strategy.

- The participant then elects to invest his or her contract value in accordance with the selected asset allocation model and to remain invested in such model until such time as the participant directs otherwise, and provides instruction to that effect to the fiduciary adviser and insurance company.
- In the particular case of certain guaranteed benefits that may be available for the participant to elect,<sup>3</sup> the participant must allocate some or all of their contract value among then available and approved model portfolios. Thereafter, the participant remains free to switch to other approved model portfolios. If the participant discontinues using an approved model (or other approved underlying funds), then the participant will forfeit such guaranteed benefit. (Other aspects of such benefits such as guaranteed minimum death benefits may remain intact in these circumstances.)
- Pursuant to the standing directions of the participant, the fiduciary adviser periodically rebalances the account to the last allocation model approved by the participant. This rebalancing is within the scope of the express investment direction provided by the participant.
- The fiduciary adviser is also instructed by the participant to propose from time to time to the participant updates to the selected model portfolio or refinements to the weighting of the portfolio, among then current or new investment options, in order to continue to implement the investment decision made by the participant. In all cases, the objective of any such proposal is to preserve the investment profile and tolerances previously directed by the participant. By way of example, the following are among the more prevalent circumstances where a fiduciary adviser might propose an update to or other reallocation of the underlying funds within a model portfolio:
  1. One of the funds in the portfolio merges, liquidates or changes investment objectives/strategies and no longer represents the target composition or risk-return paradigm intended for the portfolio. The fiduciary reviews the other fund options available to the participant and, on a basis consistent with generally accepted investment theory, proposes a substitute for the existing fund that better represents the intended function of that option in the portfolio.
  2. In the course of monitoring the portfolio, the fiduciary adviser determines that there has been a material change in one of the funds underlying the portfolio or available to the participant, typically under empirical standards for asset class, style drift, historical returns, volatility

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<sup>3</sup> For example, Hartford may offer an optional guarantee that the participant's account will provide a specified level of retirement accumulation or minimum annual withdrawal or lifetime income, regardless of investment performance.

characteristics, or other characteristics. In some cases, a fund included in the portfolio may no longer fulfill its intended function in the portfolio. In other cases, a fund not included in the portfolio may have evolved to become a better fit than the comparable fund in the portfolio. In either case, the fiduciary adviser advises that the now more suitable fund be substituted for the existing fund.

3. One of the underlying funds in the portfolio suffers a material adverse event, such as a change in management, downgrading of investments, precipitous losses or an adverse regulatory, litigation or similar event. In this case, the fiduciary adviser may conclude that the existing fund no longer merits the confidence previously placed in it, and recommends that it be replaced in the portfolio by a fund with comparable investment characteristics that has not experienced such an adverse event.
4. The fiduciary adviser may propose that the model be periodically refreshed to reset asset class allocations to accurately reflect the risk level of the model, sometimes as frequently as quarterly, but no less than annually. For example, over the last ten years, the commonly accepted allocation in a moderate allocation portfolio for international equities in developed economies has ranged from roughly 5% to 20%, given the risk/reward characteristics of the asset class. These asset allocation adjustments do not reflect any redesign of the objectives for such a portfolio; rather, they reflect the inevitable changes in the risk/reward characteristics of asset classes as economic and market conditions change over time. In these circumstances, the fiduciary adviser recommends a periodic reweighting of the funds utilized in the portfolio so that it preserves the overall investment objective selected by the participant, in a manner consistent with generally accepted asset allocation theory.
5. The fiduciary adviser may also propose that the model be periodically refreshed to maintain the desired asset allocation exposures given the exposures incurred by the underlying funds, sometimes as frequently as quarterly. The mix of the holdings of the underlying funds creates the absolute exposure for the portfolio, and those holdings and the asset classes they represent can change over time. Therefore, periodic reviews are conducted to reaffirm that the combination of the underlying holdings from funds utilized in the models still represent the intended overall asset allocation of the given model. Subsequent changes may be made given the outcome of the review, to either readjust percentages of existing funds or replace funds to maintain the intended asset allocation outcome. These adjustments do not reflect any redesign of the objectives for the portfolio; rather, they ensure that there are not unintended consequences from the mix of the underlying holdings within the underlying funds and that it

preserves the overall investment objective selected by the participant, in a manner consistent with generally accepted asset allocation theory.

- Participants are notified in writing or by electronic communications of the proposed reallocations to their model portfolio. The notice explains that participants have the right to reject changes and are typically provided at least thirty (30) days to instruct the fiduciary adviser as to the investment of their accounts.
  1. If the participant does not “opt out” of the proposed changes within the specified period, that constitutes a direction to the fiduciary adviser to implement those changes. This negative consent procedure is a term of the agreement between the participant and the fiduciary adviser, and is explicitly reiterated in every notice to the participant of a recommended change in the model portfolio.
  2. If the participant chooses to opt out for his or her account, no change is made in the investment of his or her account by reason of the fiduciary adviser’s recommendation. (Changes could occur where a fund is liquidating or otherwise is not longer available for reasons other than the fiduciary adviser’s recommendation.) The dynamic asset allocation agreement between the participant and the fiduciary adviser terminates by its terms—since the participant has determined that the model portfolios, which constitute the advisory service offered by the fiduciary adviser under the agreement, no longer fit his or her needs. The participant is free to manage the account in any way he or she determines and is permissible under the plan, including to engage the fiduciary adviser or any other investment adviser for a different kind of advisory service or to direct the investment of the account without any professional advice. As noted above, opting out may also extinguish optional guarantees where participation in a model portfolio is a condition precedent to the availability of those guarantees.

Accordingly, under this opt out structure, the fiduciary adviser provides at most recommendations to the participant, and all investment activity is taken only at the sole direction of the participant.

#### *Legal Treatment of Opt-Out Dynamic Asset Allocation Models*

In the ordinary legal understanding of the terms, the investment decisions in the opt-out dynamic asset allocation program described above are made “solely at the direction” of the participant. The fiduciary adviser has no authority to manage the assets in the participant’s account or to effect any investment transaction, other than as directed by the participant. The fiduciary adviser’s role is wholly advisory; the investment decision making is entirely the

participant's. Consequently, programs with these characteristics are within the scope of section 408(b)(14) and 408(g).

That conclusion is consistent with the Department's own analysis of conceptually comparable issues under ERISA. For example, in its 1997 advisory opinion to Aetna Life Insurance and Annuity Company, the Department, in the context of reviewing the management and selection of investment options for a 401(k) plan, advised that a company providing "non-discretionary administrative and recordkeeping services pursuant to detailed administrative guidelines described in the Plan services agreement" would generally not be a fiduciary with respect to the plan. Furthermore, "a person would not be exercising discretionary authority or control over the management of a plan or its assets solely as a result of deleting or substituting a fund from a program of investment options and services offered to plans, provided that the appropriate plan fiduciary in fact makes the decision to accept or reject the change."<sup>4</sup> While the legal issues considered in the Advisory Opinion are not identical to those under section 408(b)(14) and 408(g), the conceptual outcomes should be the same.

As further confirmation, we note that this conclusion is also conceptually consistent with the views of the staff of the Securities and Exchange Commission ("SEC") specifically in the context of asset allocation programs for variable annuity contracts. In November 2003, the staff of the SEC Division of Investment Management sent a letter to a number of insurance companies requesting information about their asset allocation models for variable contracts. The SEC staff was particularly interested in information on dynamic models and specifically requested (1) an analysis of whether the models involve the provision of investment advice to contract owners by the insurer or the third party responsible for changing the models, and (2) information about whether any such persons or organizations providing such advice were registered as investment advisers under the Investment Advisers Act of 1940 and were complying with the Advisers Act's requirements in this context. In April 2005, after examining the information submitted in response to its letters, the staff contacted insurers, including Hartford, to discuss its views of variable contract asset allocation models.<sup>5</sup> The staff informally stated that dynamic programs involve the provision of investment advice and therefore must include an investment adviser having an advisory relationship with each participant. The staff also expressed the view that dynamic programs provide participants with sufficient discretion so as not to require registration of the model portfolio as an investment company under the Investment Company Act of 1940. That is, in the securities regulatory context, the staff essentially concluded that the services provided under dynamic asset allocation programs for variable annuities are advisory in nature, but do not constitute management of the account assets by the adviser—characterizations entirely consistent with the proposed treatment of such programs under section 408(b)(14) and 408(g).

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<sup>4</sup> Advisory Opinion 97-16A (May 22, 1997).

<sup>5</sup> This examination did not result in any written guidance that has been made publicly available. Representatives of Hartford were directly involved in these discussions with SEC staff, which have also been reported in contemporaneous industry materials. See, e.g., Jeffrey S. Poretz and Alison Ryan, *Asset Allocation Programs: Regulatory Issues Surrounding Use with Variable Insurance Products*, ALI-ABA Conference on Life Insurance Company Products (November 3-4, 2005).



### *Requested Clarification*

The Department should make clear that all the activities of the fiduciary adviser in an “opt-out” dynamic asset allocation structure as described above are within the scope of the relief provided under section 408(b)(14), under either the level fee provision or the computer model provision of section 408(g). In particular, the specific investment purchases and sales in any such structure should be treated as having been made “solely at the direction” of the participant within the meaning of section 408(g)(3)(D)(ii) and section 408(g)(7)(B), and for the corresponding purposes of the proposed class exemption, where:

- The participant selects the asset allocation model to be implemented;
- The fiduciary adviser provides reasonably contemporaneous notice to the participant of any recommended revisions in that model; and
- The participant can on reasonably short notice “opt out” of the asset allocation model as revised.

We see no reason in the statute, policy or existing regulatory guidance to require that the participant affirmatively “opt in” to any changes in the model recommended from time to time by the fiduciary adviser. The statute requires only that investment decisions be made “solely at the direction” of the participant; it does not require an affirmative consent procedure. “Opt-in” asset allocation programs are also within the scope of the exemption, but are not the exclusive means by which participants can express their investment directions. As is apparent, opt-in programs are less efficient and more expensive for fiduciary advisers to administer—inefficiencies and costs that are in the end borne by participants. In fact, Hartford’s expense modeling and experience suggest that such a program can become prohibitively expensive, and thus of no interest to plan participants, fiduciaries, or providers. We see no basis to think that Congress intended to unnecessarily burden investment advice programs within the scope of the exemption with an affirmative consent requirement, which in the final analysis would be counterproductive to Congress’ ultimate objective of expanding professional investment services actually delivered to participants. This point is fundamental to the practical utility of the exemption, and should be clarified in the promulgation of the final regulations and proposed class exemption.

### Bonuses under the Fee-Leveling Exemptions

At the Department’s invitation, we describe below the bonus program Hartford proposes to make available to its fiduciary advisers relying on the level fee statutory or proposed class exemption, in the belief that it is consistent with the principles underlying the those exemptions and may provide a basis for further elaboration of this point by the Department.

By way of background, we note that the Hartford corporate enterprise is organized so that the employees of all business units are, as a formal legal matter, employees of a single affiliate. Employees are assigned to work for and at the direction of one or more business units and may



move (i.e., are “shared”) from time to time, for example, between a fiduciary adviser providing participant advice and other business units. Hartford adopted this structure for the administrative convenience and cost savings of operating a single, enterprise-wide human resources function, as opposed to operating human resources, payroll, benefits and other administrative functions in each of its business units. This is a common structure in large business enterprises, including other diversified financial services companies. We understand the level fee requirement under the statute as interpreted in Field Assistance Bulletin (“FAB”) 2007-01 (Feb. 2, 2007) and proposed Section 2550.408g-1(c)(1)(iii) to attach to the Hartford entity (generally, a registered investment adviser) to which the individual fiduciary adviser reports and is responsible in providing investment advice to participants, rather than to the Hartford affiliate that is legally the employer of all the shared employees in the Hartford enterprise.

All Hartford employees participate in the same annual incentive program which is based substantially on an enterprise-wide measure of results. These types of annual incentive plans are designed to provide eligible employees with the opportunity to participate in the overall success of the company and to also recognize employees who have consistently demonstrated exceptional performance. Commonly, these incentive plans reflect corporate and line of business profits, returns on investments, share price and a wide variety of other intangible business accomplishments. In the case of individual fiduciary advisers, they would participate in a bonus program keyed to the enterprise-wide results of Hartford Life Insurance Company. Those results reflect the performance of the following product lines:

- Life insurance: fixed and variable products in individual, group and corporate markets.
- Annuities: fixed and variable products in retail and retirement markets.
- Mutual funds: retail and retirement markets.

Of these various product lines, the only economic results in the Hartford enterprise affected by the investment decisions made by participants under investment advice programs would be those for variable annuities in the retirement market, and even there only a *fraction* of the results for that product line (from direct fees, 12b-1 and transfer agent fees, and all other sources of revenue) would vary with the investment decisions made by *all* participants under *all* investment advice programs. The bonuses for fiduciary advisers, however, would materially reflect the performance of multiple product lines, and less than 50% of that bonus would be based on the results of variable annuities sold in the retirement market. Accordingly, this bonus structure would not be a proxy for compensation based on the investments selected by the participants advised by a fiduciary adviser, and is allowable either for individual fiduciary advisers or for employees (including “shared” employees) of a corporate fiduciary adviser under either of the level fee exemptions.

To the extent the foregoing description permits the Department to provide further elaboration of this point in the issuance of the final regulations and class exemption, such an elaboration would advance the compliance efforts of the industry.

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Thank you for your consideration of our comments. We would be pleased to amplify or discuss this letter at your convenience, if that would be helpful to the Department.

Very truly yours,

A handwritten signature in black ink, appearing to be 'R. Wirth', written over a vertical dashed line.

Richard J. Wirth,  
Assistant Vice President, Assistant General  
Counsel

cc: Robert Doyle  
Ivan Strasfeld  
Louis J. Campagna, Jr.  
Fred Wong